SUPREME COURT, U. S.
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IN THE SUPREME COURT OF THE UNITED STATES

October Term, 1966

No. 880

ROBERT A. KENNEDY, as Treasurer of the State of Arizona, ROY L. THORNBRUGH, as Registrar of Contractors of the State of Arizona and GARNER ELECTRC COMPANY,

Petitioners,

vs.

LOUISE POWELL, Trustee in Bankruptcy of the Estate of Leon Showalter, bankrupt,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF OF THE STATES OF ALABAMA, ARKANSAS, CALIFORNIA, DELAWARE, HAWAII, IDAHO, LOUISIANA, MAINE, MARYLAND, MICHIGAN, NEVADA, NORTH CAROLINA, NORTH DAKOTA, OKLAHOMA, PENNSYLVANIA, SOUTH CAROLINA, SOUTH DAKOTA, TENNESSEE, UTAH, VIRGINIA, AND WYOMING AS AMICI CURIAE IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI

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IN THE SUPREME COURT OF THE UNITED STATES

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The States of Alabama, Arkansas, California, Delaware, Hawaii, Idaho, Louisiana, Maine, Maryland, Michigan, Nevada, North Carolina, North Dakota, Oklahoma, Pennsylvania, South Carolina, South Dakota, Tennessee, Utah, Virginia, and Wyoming, through their Attorneys General, respectfully submit this joint brief as amici curiae under Rule 42(4) Rules of the Supreme

Court, in support of the Attorney General of Arizona for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit to review its Judgment in *Kennedy vs. Powell*, 366 F.2d 346 (1966).

REASONS FOR GRANTING THE WRIT
ARGUMENT

I. THE CASE PRESENTS AN IMPORTANT FEDERAL QUESTION RELATIVE TO THE ADMINISTRATION OF BANKRUPTCY ESTATES.

As stated in the Petition, the question presented involves an important issue of federal bankruptcy law which has not been, but should be decided by this Honorable Court.

The decision of the Ninth Circuit, if allowed to stand, will affect bonding legislation and creditors' rights throughout the entire country. This is not an isolated case of a peculiar statute. All of the States who are parties to this amici curiae brief have bonding statutes which are conditioned solely for specific beneficiaries, as is the Arizona statute in question. Additionally, many of the statutes provide for deposits of cash or other securities in lieu of surety bonds. Therefore, the decision is of vital concern to all.

Some of the bonding provisions of each party hereto follow. Selective ones have been placed in the Appendix.

Alabama

Code of Ala; Tit. 22, §216
Re: Milk Dealers

Code of Ala; Tit. 46, §311(5) (c) (d)
Re: Real Estate Brokers and Salesmen

Code of Ala; Tit. 50, §16
Re: Public Works Contracts

Arkansas

71 Arkansas Statutes 1305
Re: Real Estate Broker or Salesman

71 Arkansas Statutes 880(m)
Re: Cosmetology School

California

Section 7071.5, as amended, (1965)
California Business and Professions Code (See Appendix E).
Re: Contractors

Sections 7071.6, as amended (1965) and
7071.9, as amended (1965), California Business and
Professions Code (See Appendix P, Arizona's Petition)
Re: Contractors

Delaware

29 Del. C. §6910
Re: Public Works Contracts

Hawaii

§160 - 168, Revised Laws of Hawaii, 1955, as amended
Re: Motor Vehicle Dealers

§160 - 170.555, Revised Laws of Hawaii 1955, as amended
Re: Motor Vehicle Salesmen

§193 - 20, Revised Laws of Hawaii, 1955, as amended

§9-31.33, Revised Laws of Hawaii, 1955
Re: Public Works Contracts

§199 - 11(c), Revised Laws of Hawaii, 1955, as amended

§199 - 16(b), Revised Laws of Hawaii 1955, as amended
Re: Dealers or Salesmen of Securities

Idaho

§54-2029, Idaho Code, 1947, as amended

§54-2035, Idaho Code, 1947
Re: Real Estate Brokers

§54-2612, "Idaho Private Contractors License Act II added 1965
Re: Contractors (See appendix F)
§54-1926, 1927, "Idaho Public Contracts Bond Act," added 1965 (See Appendix G)

Louisiana

§38:2241, Louisiana Revised Statutes, 1950
§38:2247, Louisiana Revised Statutes, 1950 as amended
Re: Public Works Contracts

Maine

§ 32-852 Maine Rev. Stats.
Re: Securities Dealers

Maryland

Art. 90, §11, An. Code
Re: Public Works Contracts

Michigan

Sections 5.2321(1)-(11) incl.; 26.321, Mich. Stats.
Re: Public Works Contracts
Section 9.1948, Mich. Stats.
Re: Motor Vehicle Dealers, Brokers, Etc.
Section 19.762 Mich. Stats.
Re: Securities Dealers
Section 12.105(8) Mich. Stats.
Re: Wholesale Potato Dealers

Nevada

N.R.S. 624.270
Re: Private Contractors

North Carolina

§106-498 Gen'l. Stats. N.C.
Re: Handlers of Farm Products (See Appendix H)

North Dakota

N.D.C.C. 48-01-01
Re: Public Works Contracts

Oklahoma

52 O.S. 1961 §373
Re: Dealers of Equipment and Materials Incident to Development of Oil and Gas Properties

61 O.S. 1961 §§ 1 and 2
Re: Public Works Contracts

71 O.S. 1961 §202
Re: Securities' Broker-Dealers

Pennsylvania

36 P.S. 670-404
Re: State Highway Contracts

53 P.S. 1291-1294
Re: Municipality Public Works

24 P.S. 7-756, 757
Re: School District Contracts (Sec. 756—See Appendix I)

South Carolina

§33-224 C.L.S.C.
Re: Public Highway Contracts

§62-111 C.L.S.C.
Re: Securities' Brokers

South Dakota

S.D.C. 1960 Supp. §65.0702
Re: Public Works Contracts

Tennessee

§62-422(6) Tenn. Code
Re: Cosmetology School

§43-2103, 2105 Tenn. Code
Re: Bond of Tobacco Warehouseman

§49-4001 Tenn. Code
Re: Bond of Privately Owned Correspondence School

Utah

§14-2-1, 2 Utah Code
Re: Private Construction Contracts

§ 14-1-(1-4) incl. Utah Code
Re: Public Contracts

Virginia

§ 54-844-845 Code of Va. 1950
Re: Pawnbrokers

§ 54-767-9 Code of Va., 1950
Re: Real Estate Brokers

Wyoming

§ 33.99.3 Wy. Stats. 1957, as added 1961
Re: Barber Schools

§ 37-227 Wy. Stats, 1957
Railroad Construction Contracts

§ 33-348 Wy. Stats. 1957
Real Estate Brokers

§ 9-674-677 Wy. Stats. 1957
Re: Public Works Contracts

The core of our modern credit system of transacting business is security. Each of the aforesaid statutes, along with others not placed in this brief, affords some protection to specific types of persons or institutions who extend credit. Only those specific classes of creditors enumerated can recover on the bonds listed.

By the instant decision, however, no mention was made as to whether the security in issue could be used to pay the bankruptcy trustee's costs of administration or claims of general creditors. The decision leaves a void which needs to be filled by this Court. Otherwise, secured creditors will forever be deprived of vested rights as was stated by Judge Koelsch in his dissent.

Another interesting situation, not pointed out in the Petition, is presented by the instant decision. Many commercial surety companies require that applicants for surety bonds deposit collateral as a condition precedent to securing a bond. What would happen to this collateral upon a declaration of bankruptcy? If the decision of the Ninth Circuit is correct, then must it not follow that the surety companies would lose the collateral posted by the bankrupt? We think the principle enunciated is clearly wrong.

II. CONFLICT OF AUTHORITIES

As was pointed out in the Petition, this precise issue has arisen at least two times in the Federal District Courts of California. In the case of *J. W. Mitchell, dba Mitchell Construction, bankrupt, et al, vs. Contractors' State License Board of the State of California,* Bankruptcy No. 198258-PH, the Honorable Referee in Bankruptcy refused to grant an Application for a Turnover Order to the Trustee in Bankruptcy. (See Appendix O, Arizona's Petition) The pleadings with reference to said case have been placed in the Appendix. See Application for Turnover Order (Appendix A); Order to Show Cause in Re Application for Turnover Order (Appendix B); Answer to Trustee's Application for Turnover Order and Points and Authorities in Opposition to Turnover Order (Appendix C).

At the time of filing Arizona's Petition, the matter of *Jolly William Kile,* No. 212987-EC, was pending in the United States District Court for the Central District of California. Since then, however, the referee in that case similarly refused to grant the Application for Turnover Order. (Note—California's answer to

Trustee's Application for Turnover Order and Points and Authorities in Opposition to Turnover Order has been inserted herein as Appendix D.)

Another impelling reason for supporting Arizona's Petition is that no distinction in principle should be made as to the form of security. What difference does it make whether it consists of a cash deposit, some other type of collateral, or a surety bond.

There have been some cases where only a surety bond, as distinguished from a cash deposit, was involved. Nevertheless, the court held that such bonds and the proceeds thereof were not "property" within the Bankruptcy Act. In the case of *Betzer vs. Olney,* 14 Cal. App.2d 53, 57 P.2d 1376 a securities broker had posted a bond in compliance with the Corporate Securities Act of California. There it was contended that the Bankruptcy trustee had a right to administer any amounts recovered upon the bond. The court did not agree. It held that a recovery on the bond was not within the terms of the Bankruptcy Act and did not become part of the assets of the bankruptcy estate.

For a case similar in principle see *Kreimer vs. Second Fed. Sav. and Loan Ass'n of Pittsburgh,* 196 Pa. Sup 644, A.2d 132 (1961). See also the other cases cited in Arizona's Petition. In short we go along with petitioner's argument that the form of the deposit, when it is intended for specific beneficiaries, should not be a controlling factor.

The impact this decision will have on our economy is not to be taken lightly. In the States of California, Washington and Arizona approximately 15 million dollars cash or other types of collateral are deposited pursuant to the contractor's licensing laws alone. See Arizona's Petition page 6 and Washington's amicus curiae brief, page 3. With the magnitude of the sums involved in these three particular instances alone, the overall bonding picture would most certainly reach gargantuan proportions.

CONCLUSION

We concur with the position of the Attorney General of Arizona that the Ninth Circuit was clearly wrong in making its decision. Because of the effect this decision will have in all of the states who are parties to this Amici Curiae Brief, we urge that the Petition for Writ of Certiorari be granted.

Respectfully submitted,

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APPENDIX A

IN THE UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF CALIFORNIA
CENTRAL DIVISION

In the Matter of J. W. MITCHELL (ngn) fdba MITCHELL CONSTRUCTION, Bankrupt.	In Bankruptcy No. 198258-PH
C. DOUGLAS WIKLE, as Trustee in Bankruptcy of J. W. MITCHELL (ngn) fdba MITCHELL CONSTRUCTION, Applicant, vs. CONTRACTORS' STATE LICENSE BOARD, OF THE STATE OF CALIFORNIA, Respondent.	APPLICATION FOR TURNOVER ORDER

TO THE HONORABLE JOHN E. BERGENER, REFEREE IN BANKRUPTCY:

The application of C. DOUGLAS WIKLE respectfully represents as follows:

I

That above named J. W. Mitchell, fdba Mitchell Construction, was duly adjudged bankrupt on a petition filed in this Court by it on October 6, 1965.

II

Your petitioner is the Trustee of the estate of said bankrupt, duly qualified and acting.

III

At the time of the filing of said petition in bankruptcy, the above named respondent, Contractors' State License Board of the State of California, had in its possession or under its control a Bank of America Certificate of Deposit in the amount of one thousand ($1,000.00) dollars belonging to this estate.

IV

At the time of the filing of said petition, the said Contractors' State License Board had no claim adverse to your applicant to said one thousand ($1,000.00) dollars.

V

Respondent now has in its possession or under its control the aforesaid one thousand ($1,000.00) dollars.

VI

Your applicant is entitled to the immediate possession of said one thousand ($1,000.00) dollars.

VII

Your applicant has made demand upon said respondent for the surrender of possession of said one thousand ($1,000.00) dollars and the said respondent has failed and refused to comply with such demand.

WHREFORE, your applicant prays that said respondent be directed forthwith to surrender possession of said one thousand ($1,000.00) dollars to your applicant forthwith, and that your applicant have such other and further relief as is just.

DATED: Los Angeles, California, this.....day of December, 1965.

.....

C. DOUGLAS WIKLE, Applicant

.....

FRANCES O. DRUMMOND,
Attorney for Applicant

APPENDIX B

IN THE UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF CALIFORNIA
CENTRAL DIVISION

In the Matter of J. W. MITCHELL (ngn) fdba MITCHELL CONSTRUCTION, Bankrupt.	In Bankruptcy No. 198258-PH
C. DOUGLAS WIKLE, as Trustee in Bankruptcy of J. W. MITCHELL (ngn) fdba MITCHELL CONSTRUCTION, Applicant, vs. CONTRACTORS' STATE LICENSE BOARD OF THE STATE OF CALIFORNIA, Respondent.	ORDER TO SHOW CAUSE IN RE APPLICATION FOR TURNOVER ORDER

Upon reading and filing the application of the Trustee herein, C. DOUGLAS WIKLE, and good cause appearing therefor,

IT IS HEREBY ORDERED that a duly authorized representative of the Respondent, Contractors' State License Board of the State of California, shall be and appear before the undersigned Referee in Bankruptcy at his Courtroom No. 314, United States Courthouse Building, Temple and Spring Streets, Los Angeles 12, California, on January 27, 1966, at 2:00 p.m. thereof, and then and there show cause if any it has why an Order should not be entered herein adjudging and decreeing that said respondent surrender possession of one thousand ($1,000.00) dollars to

the Trustee herein, C. Douglas Wikle, which sum is described in the application filed on behalf of the trustee.

IT IS FURTHER ORDERED that a copy of the within Order to Show Cause and the application on behalf of the trustee upon which it is based shall be served by United States Mail, postage prepaid, at least 10 days prior to the date of the hearing as set forth herein.

IT IS FURTHER ORDERED that pursuant to Rule 203 (a) of this Court, if Respondent desires to contest the within Order to Show Cause or the Application upon which the same is based it shall serve and file its Answer or Response in writing at least two (2) days prior to the date of hearing as set forth herein.

DATED: Los Angeles, California, this 6 day of January, 1966.

JOHN E. BERGENER

JOHN E. BERGENER
REFEREE IN BANKRUPTCY

APPENDIX C

IN THE UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF CALIFORNIA
CENTRAL DIVISION

In the Matter of J. W. MITCHELL (ngn) fdba MITCHELL CONSTRUCTION, Bankrupt.	In Bankruptcy No. 198258-PH
C. DOUGLAS WIKLE, as Trustee in Bankruptcy of J. W. MITCHELL (ngn) fdba MITCHELL CONSTRUCTION, Applicant, vs. CONTRACTORS' STATE LICENSE BOARD, OF THE STATE OF CALIFORNIA, Respondent.	ANSWER TO TRUSTEE'S APPLICATION FOR TURNOVER ORDER AND POINTS AND AUTHORITIES IN OPPOSITION TO TURNOVER ORDER

TO THE HONORABLE JOHN E. BERGENER, Referee in Bankruptcy:

Contractors' State License Board of the State of California, answers the application of C. Douglas Wikle praying for a turnover of property, as follows:

FIRST DEFENSE

1. Respondent admits the allegations contained in paragraphs I, II, VII of the application.

2. Respondent denies each and every allegation contained in paragraphs III through VI of the application.

SECOND DEFENSE

3. Respondent alleges that on September 21, 1964, Leo B. Hoschler, Registrar of Contractors of the State of California received a Certificate of Deposit in the sum of $1,000.00 from Mitchell Construction Co. as a condition precedent to issuance of a state contractor's license. The cash deposit was required pursuant to section 7071.9 of the Business and Professions Code and is for the benefit of (a) any person damaged as a result of a violation of Chapter 9, Division 3, of the Business and Professions Code by the licensee, (b) any person damaged by fraud of the licensee in the execution or performance of a contract, and (c) any employee of the licensee damaged by the licensee's failure to pay wages or fringe benfits.

4. The Registrar of Contractors holds the $1,000.00 Certificate of Deposit at the present time subject to claims of statutory beneficiaries. Pursuant to section 7071.6 of the Business and Professions Code, claimants have a minimum of two years within which to commence an action to recover from the cash deposit.

5. The interest of Mitchell Construction Co. in the $1,000.00 Certificate of Deposit did not pass to the Trustee in Bankruptcy in that said interest was not capable of assignment or subject to execution according to applicable state law.

THIRD DEFENSE

6. The bankruptcy court is without summary jurisdiction in that the property in controversy was in the actual or constructive possession of the Registrar of Contractors at time of the commencement of the bankruptcy proceeding. The Registrar claims that the property must be held for the statutory beneficiaries (Business and Professions Code § 7071.9) and for the period in which claims may be filed (Business and Professions Code § 7071.6).

7. The Bank of America, Goleta Branch, 5777 Hollister

Avenue, Goleta, California on September 13, 1965 made written demand on the Registrar for the Certificate of Deposit.

8. Unless the adverse claimants consent to summary jurisdiction, the claims must be decided in a court of competent jurisdiction.

FOURTH DEFENSE

9. The application fails to state a claim against respondent upon which relief can be granted.

WHEREFORE, your respondent prays that the application be denied with costs.

Dated this 21st day of January, 1966.

THOMAS C. LYNCH, Attorney General
By HENRY G. ULLERICH
HENRY G. ULLERICH
Deputy Attorney General
Attorneys for the Contractors' State License Board

VERIFICATION

HENRY G. ULLERICH declares:

That he is a Deputy Attorney General of the State of California and attorney for the respondent Contractors' State License Board, that he has read the foregoing answer and knows the contents thereof, and that the same are true of his own knowledge, except as to the matters therein stated to be alleged on information and belief, and as to those matters he believes them to be true.

I declare under penalty of perjury that the foregoing is true and correct.

Executed at Los Angeles, California, on January 21, 1966.

HENRY G. ULLERICH
HENRY G. ULLERICH
Deputy Attorney General

POINTS AND AUTHORITIES

At the time the bankruptcy proceeding was initiated, sections 7071.9 and 7071.6 of the California Business and Professions Code provided in pertinent part as follows:

"Except as provided in Section 7071.5, the board shall require, on or after January 1, 1964, as a condition precedent to the issuance, reinstatement, reactivation, or reissuance of a license, and on or after July 1, 1965, as a condition precedent to the renewal of a license, that the applicant file or have on file with the registrar a bond issued by an admitted surety in the sum of one thousand dollars ($1,000) in favor of the State of California, or in lieu thereof, that such applicant post with the resigtrar a cash deposit in the sum of one thousand dollars ($1,000). Such bond or cash deposit required by this section shall be for the benefit of (a) any person damaged as a result of a violation of this chapter by the licensee, (b) any person damaged by fraud of the licensee in the execution or performance of a contract, and (c) any employee of the licensee damaged by the licensee's failure to pay wages or fringe benefits." (§ 7071.9.)

"Any person claiming against any bond or cash deposit required by this article may maintain an action at law against the licensee and the surety or the cash depository, *but such action must be brought within two years after the expiration of the license period or periods for which a bond or cash deposit has been provided.*

"The claim of any employee of the contractor for wages shall be preferred claim against any bond or cash deposit.

"If any bond or cash deposit which may be required is insufficient to pay all claims in full, the sum of the bond or cash deposit shall be distributed among all claimants in proportion to the amount of their respective claims with priority given to claims for wages. The partial payment of any claims shall not be considered satisfaction of said claims and the claimants may institute appropriate legal actions for payment of any unpaid balance in any other manner provided by law, and the registrar may continue suspension or revocation of any license involved

until such time as said claims and any others arising out of an action against such bond or cash deposit are satisfied in full.

"The aggregate liability of the surety for all claims of said persons shall, in no event, exceed the penal sum of said bond.

". . . .

". . . ."

The underlined language was added effective September 17, 1965.

Section 7071.6 formerly contained the following paragraph:

"If the surety desires to make payment without court action, the amount of the bond shall be reduced to the extent of any payments made by the surety in good faith hereunder. If the licensee desires to make payments without court action, the licensee may authorize the cash depository, in writing, to pay the claimant and the cash deposit shall be reduced to the extent of any payment made."

Section 70 (a) (5) of the Bankduptcy Act provides that the trustee is vested by operation of law with the title to property which prior to the filing of the petition, the bankrupt could have transferred or which might have been levied upon and sold under judicial process.

The interest of the bankrupt in the Certificate of Deposit at the time of the bankruptcy was contingent. That is, he could not demand the return of the money. He could not transfer title. The fund could not be levied upon by general creditors. The bankrupt had an expectancy that any balance would ultimately be returned to him after the expiration of the time for filing claims. (See *Bunnell* v. *Bosich Bros. Const. Co.* 43 Cal.App.2d 538, 540.)

Where a bankrupt had posted a surety bond with the Commissioner of Agriculture of Florida for the benefit of citrus producers, the court reversed an order by the referee to turn the money over to the trustee.

In re Goldsby, 51 F.Supp. 849 (S.D. Fla. 1943).

In the case of *Betzer* v. *Olney,* 14 Cal.App.2d 53, 62 hearing

denied, the bankrupt had posted a bond pursuant to the Corporate Securities Act of California. It was held by the court, with further hearing denied by the Supreme Court, that such a bond carried with it a definite contractual right in favor of the beneficiaries under the bond and that such right was neither directly or indirectly a part of the assets of the bankrupt estate.

Clearly, the bankrupt would not have a sufficient interest in the cash deposit to sustain a federal tax lien.

Fidelity & Deposit Co. v. *New York City Housing Auth.*, 241 F.2d 142 (2d Cir. 1957).

By analogy, the bankrupt would not possess an asset that would pass to the trustee in bankruptcy under section 70 of the Bankruptcy Act.

A state department withheld a percentage of a contract for the benefit of laborers and furnishers of materials on state highways. The contractor was adjudicated a bankrupt. The District Court vacated a turnover order. The Circuit Court of Appeals affirmed, holding that until it had been determined that there was a surplus belonging to the bankrupt, the fund was the property of the state and in its custody. The court further held that the state was a party claiming adversely to the trustee, which would bar a summary proceeding.

Dannel v. *Wilson-Weesner-Wilkinson Co.*, 109 F.2d 364 (6th Cir. 1940).

Of course, where the controversy is one involving property in the actual or constructive possession of a third person asserting a bona fide adverse claim, the bankruptcy court has no juridiction to determine summarily that person's claim upon petition by the trustee, unless by that person's consent.

Harrison v. *Chamberlin*, 271 U.S. 191.

CONCLUSION

In conclusion, it is submitted that turnover proceedings are

only permitted where the property is vested in the trustee by virtue of section 70 (a) of the Bankruptcy Act, and that the property in question was at the date of bankruptcy either in the actual or the constructive possession of the bankruptcy court. The trustee has failed to meet those conditions in the instant case, and the application should be denied.

Respectfully submitted,
THOMAS C. LYNCH, Attorney General
By HENRY G. ULLERICH
HENRY G. ULLERICH
Deputy Attorney General

APPENDIX D

UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

In the Matter of JOLLY WILLIAM KILE, Bankrupt.	No. 212,987-EC
ROBERT H. STOPHER, as Trustee in Bankruptcy of JOLLY WILLIAM KILE, Applicant, vs. TRUSTEES OF LABORERS HEALTH AND WELFARE FUND FOR SOUTHERN CALIFORNIA, TRUSTEES OF CONSTRUCTION LABORERS PENSION TRUST FOR SOUTHERN CALIFORNIA, TRUSTEES OF CONSTRUCTION LABORERS VACATION TRUST FOR SOUTHERN CALIFORNIA, REGISTRAR OF CONTRACTORS, CONTRACTORS' STATE LICENSE BOARD OF THE STATE OF CALIFORNIA, served herein as REGISTRAR OF CONTRACTORS, and BANK OF SANTA ANA, Respondents.	ANSWER TO TRUSTEE'S APPLICATION FOR TURNOVER ORDER AND POINTS AND AUTHORITIES IN OPPOSITION TO TURNOVER ORDER

TO THE HONORABLE ROBERT B. POWELL, REFEREE IN BANKRUPTCY:

REGISTRAR OF CONTRACTORS, CONTRACTORS'

STATE LICENSE BOARD OF THE STATE OF CALIFORNIA, severing himself from all other respondents and responding in his own behalf alone, answers the application of ROBERT H. STOPHER, trustee in bankruptcy, praying for a turn over of property, as follows:

FIRST DEFENSE

1. Respondent REGISTRAR OF CONTRACTORS denies each and every allegation contained in paragraphs I and IV of the application.

2. Respondent REGISTRAR OF CONTRACTORS admits the allegations contained in paragraph II of the application.

3. Respondent REGISTRAR OF CONTRACTORS lacks sufficient information and belief to enable him to answer the allegations contained in paragraph III, and basing his denial upon that ground, denies each and every allegation therein and the whole thereof.

SECOND DEFENSE

4. Respondent REGISTRAR OF CONTRACTORS alleges that on or about June 30, 1965, the REGISTRAR OF CONTRACTORS of the State of California received a Time Certificate of Deposit in the sum of $1,000 from JOLLY WILLIAM KILE as a condition precedent to issuance of a state contractor's license. The cash deposit was required pursuant to section 7071.9 of the Business and Professions Code and is for the benefit of (a) any person damaged as a result of a violation of chapter 9, division 3 of the Business and Professions Code by the licensee, (b) any person damaged by fraud of a licensee in the execution or performance of a contract, and (c) any employee of the licensee damaged by the licensee's failure to pay wages or fringe benefits.

5. Respondent REGISTRAR OF CONTRACTORS has continuously held, and now holds the $1,000 Time Certificate of

Deposit subject to claims of the statutory beneficiaries set forth above in paragraph 4. Pursuant to section 7071.6 of the Business and Professions Code, claimants have a minimum of two years within which to commence an action to recover from the cash deposit.

6. The bankrupt's interest, if any, in the $1,000 Time Certificate of Deposit could not and did not pass to the trustee in bankruptcy because said interest, if any, was not capable of assignment or subject to execution according to applicable state law and, furthermore, said cash deposit may be dealt with only in accordance with the aforementioned statutes.

THIRD DEFENSE

7. The bankruptcy court is without summary jurisdiction over the property in controversy in that said property was in the actual or constructive possession of the REGISTRAR OF CONTRACTORS pursuant to statutory provisions and for a period exceeding four months before the time of the commencement of the bankruptcy proceedings herein. The REGISTRAR OF CONTRACTORS claims that the property must be held for statutory beneficiaries (Bus. & Prof. Code § 7071.9) and for the period in which claims may be filed (Bus. & Prof. Code § 7071.6).

8. Unless the adverse claimants consent to summary jurisdiction in the bankruptcy court, the claims must be decided in a court of competent jurisdiction.

FOURTH DEFENSE

9. The application fails to state a claim against the respondent REGISTRAR OF CONTRACTORS upon which relief can be granted.

WHEREFORE, respondent REGISTRAR OF CONTRACTORS prays that the application be denied with costs.

DATED: November 2, 1966.

THOMAS C. LYNCH, Attorney General

By LEONARD GOLDSTEIN
LEONARD GOLDSTEIN,
Deputy Attorney General
Attorneys for Respondent
Registrar of Contractors
Contractors' State License Board
State of California

POINTS AND AUTHORITIES IN OPPOSITION TO APPLICATION FOR TURN OVER ORDER

At the time the bankruptcy proceeding herein was initiated, section 7071.9 of the California Business and Professions Code provided:

"Except as provided in Section 7071.5, the board shall require, on or after January 1, 1964, as a condition precedent to the issuance, reinstatement, reactivation, or reissuance of a license, and on or after July 1, 1965, as a condition precedent to the renewal of a license, that the applicant file or have on file with the registrar a bond issued by an admitted surety in the sum of one thousand dollars ($1,000) in favor of the State of California, or in lieu thereof, that such applicant post with the registrar a cash deposit in the sum of one thousand dollars ($1,000). Such bond or cash deposit required by this section shall be for the benefit of (a) any person damaged as a result of a violation of this chapter by the liceensee, (b) any person damaged by fraud of the licensee in the execution or performance of a contract, and (c) any employee of the licensee damaged by the licensee's failure to pay wages or fringe benefits."

And section 7071.6 of the California Business and Professions Code provided in part:

"Any person claiming against any bond or cash deposit required by this article may maintain an action at law against the licensee and the surety or the cash depository, but such action must be brought within two years after the expiration of the license period or periods for which a bond or cash deposit has been provided.

". . . .

"If any bond or cash deposit which may be required is insufficient to pay all claims in full, the sum of the bond or cash deposit shall be distributed among all claimants in proportion to the amount of their respective claims with priority given to claims for wages. The partial payment of any claims shall not be considered satisfaction of said claims and the claimants may institute appropriate legal actions for payment of any unpaid balance in any other manner provided by law, and the registrar may continue suspension or revocation of any license involved until such time as said claims and any other claims arising out of an action against such bond or cash deposit are satisfied in full.

". . . .

"Upon failure of a licensee to maintain in full force and effect any bond or cash deposit required by this article the registrar shall issue an order suspending or revoking such license, which shall not be reinstated until a new bond or cash deposit has been filed.

". . . ."

Before the 1965 amendment, section 7071.6 contained the following paragraph:

If the surety desires to make payment without court action, the amount of the bond shall be reduced to the extent of any payments made by the surety in good faith hereunder. If the licensee desires to make payment without court action, the licensee may authorize the cash depository, in writing, to pay the claimant and the cash deposit shall be reduced to the extent of any payment made."

Section 70(a)(5) of the Bankruptcy Act provides that the trustee is vested by operation of law with the title to property which prior to the filing of the petition the bankrupt could by any means have transferred or which might have been levied upon and sold under judicial process against the bankrupt, or otherwise seized, impounded, or sequestered.

The ownership of property ordinarily depends on state law. Collier, Bankruptcy § 70.07, at 980-84 (14th ed. 1959).

The interest of the bankrupt in the Certificate of Deposit at the time of the bankruptcy was contingent. It was not, however, subject to the trustee's powers as conferred in section 70(a)(7) of the Bankruptcy Act, as that secttion clearly relates only to interests in real property. Collier, Bankruptcy ¶ 70.37, at 1298, *supra.* Compliance with section 7071.9 of the California Business and Professions Code amounts to a divestiture on the part of the bankrupt for the benefit of the statutorily enumerated beneficiaries. Since the 1965 amendment to sectiton 7071.6, the bankrupt is without power to effect a transfer of the fund, nor can he demand its return. The fund cannot be levied upon by creditors, except those enumerated, and only by them if they maintain an action at law against *both* the licensee *and* the cash depository. Calif. Bus. & Prof. Code § 7071.6.

It appears from the wording of section 7071.6 that the California Legislature has made the surety or cash depository an indispensable party in an action to recover on the bond or from the fund. See *Bank of California* v. *Superior Court,* 16 Cal. 2d 516, 522, 106 P.2d 879.

In light of the foregoing, it cannot be said that the fund is property which might be levied upon and sold under judicial process against the bankrupt alone, as set forth in section 70(a)(5) of the Bankruptcy Act.

Furthermore, the bankrupt's interest, which is at most contingent during the two years after expiration of the license period, is a mere expectancy in the balance, if any, remaining after the expiration of the time for filing claims. (See *Burrell* v. *Basich Bros. Const. Co.,* 43 Cal. App. 2d 538, 540.)

The question remains, can the fund be "otherwise seized, impounded, or sequestered"? It is suggested that the phrase "otherwise seized, impounded, or sequestered" is also restricted by the

words "against him." As pointed out above, the statute appears to have made the cash depository an indispensable party to the action maintained by the enumerated beneficiaries and, therefore, the fund is not property, the disposition of which can be determined by an action against the bankrupt alone. Regardless, the California Legislature has created an exclusive avenue of access to the fund, namely, the maintaining of an action at law against the licensee and the surety or cash depository (§ 7071.6) which precludes the fund being susceptible to being "otherwise seized, impounded, or sequestered."

Even the recent case, *Kennedy* v. *Powell,* ..... F.2d ..... (9th Cir. 1966), does not compel a different conclusion.

In *Kennedy, supra,* a contractor had deposited $500 with the treasurer of the State of Arizona as a condition to receiving his license pursuant to an Arizona statute. Two judgments had been taken against the bankrupt and the treasurer jointly prior to the filing. Two more were taken after the filing. No payments had been made of the judgments and no levy had been made on the deposit.

The circuit court found the Arizona treasurer to be a mere custodian of property "which might have been levied upon and sold under judicial process against him [the bankrupt], or otherwise seized, impounded or sequestered."

The Arizona treasurer had no statutory authority to apply the funds pro rata among multiple claimants, if there were multiple claimants; he could not divest himself of the fund by paying the same into court in an interpleader action; he might be subjected to double liability. *Husky* v. *Lee,* 2 Ariz. App. 129, 406 P.2d 847.

On the contrary, the Registrar of Contractors of the State of California is more than a mere custodian. He enjoys statutory rights in the funds deposited with him which he is obligated to exercise in the name of the People of the State of California for the benefit of the statutory beneficiaries. Section 7071.6 provides

for proportional distribution with priority given to claims for wages when the deposit is insufficient to pay all claims in full. It also limits the liability of the surety to the penal sum of the bond, and by analogy, the depository to the extent of the deposit. Pursuant to title 16, chapter 8, section 791 of the California Administrative Code, Certificate of Deposit, which is the nature of the deposit in the instant case, must be made payable to the Contractors' State License Board without restriction.

And, as has been pointed out, *supra,* while funds are in the possession of the depository, they are not subject to judicial process against the bankrupt alone, and, because the California Legislature has statutorily determined the procedure for proper claimants to reach the fund in question, neither is it susceptible to being "otherwise seized, impounded, or sequestered."

In a case similar to the one at bar, the District Court for the Southern District of Florida determined in *In re Goldsby,* 51 F. Supp. 849 (S.D. Fla. 1943) that a surety bond the bankrupt therein had posted with the Commissioner of Agriculture of Florida for the benefit of citrus growers under state law was not an asset of the bankrupt and the court reversed an order by the referee to turn the money over to the trustee.

The court, referring favorably to a California case, stated on page 850:

> "The case of Betzer v. Olney, 14 Cal. App. 2d 53, 57 P.2d 1376, appears to be decisive of the point here involved. In that case the bankrupt had posted a bond in pursuance of the Corporate Securities Act of California. Proceeds of the bond were sought to be acquired by the trustee in bankruptcy as an asset of the bankruptcy estate. It was held by the California Court of Appeal, with further hearing denied by the Supreme Court, that such a bond carried with it a definite contractual right in favor of the beneficiaries under the bond, and that such right was neither directly nor indirectly a part of the assets of the bankruptcy estate. It was held that under the terms of the State law any recovery on the bond was the property of a

particular claimant and was not affected by the bankruptcy of the original debtor. The holding there is consonant with established law and with the provisions and clear intendments of the bankruptcy act itself. In this view, it is the opinion of the District Judge that the referee in bankruptcy was in error here in denying the prayer of the State Commissioner of Agriculture in his Answer to the rule to show cause."

Where the controversy regarding rights to property is one involving disputed facts, as well as a controversy in matter of law, the bankruptcy court has no jurisdiction to determine summarily the adverse party's claim upon petition by the trustee unless that party consents. *Harrison* v. *Chamberlin,* 271 U.S. 191 (1926).

CONCLUSION

In conclusion, it is submitted that turn over proceedings are permitted only when the property vests in the trustee by virtue of section 70(a)(5) of the Bankruptcy Act. In the instant case, the property did not so vest, it being beyond the control of the bankrupt and not subject to being "sold under judicial process against him, or otherwise seized, impounded, or sequestered." The trustee has failed to show that the contrary is true and the application should be denied.

Respectfully submitted,
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By LEONARD GOLDSTEIN
Deputy Attorney General
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Registrar of Contractors
Contractors' State License Board
State of California

APPENDIX E

(California Contractors' License Act)

§ 7071.5 Bond or deposit after suspension or revocation of license

If application for a license, or for restoration of a license, is made by

(1) Any person whose license has been suspended or revoked as a result of disciplinary action for violation of this chapter,

(2) Any person who was an officer, director, member, partner or qualifying individual for a licensee at any time during which cause for disciplinary action occurred resulting in suspension or revocation of said licensee's license and who had knowledge of or participated in the act or omission which was the cause for such disciplinary action for violation of this chapter,

(3) Any partnership, corporation, firm or association of which any officer, director, member, partner or qualifying person has had his license suspended or revoked as a result of disciplinary action for violation of this chapter, or

(4) Any partnership, corporation, firm or association of which any officer, director, member, partner or qualifying person was a member, officer, director, partner or qualifying person of a licensee at any time during which cause for disciplinary action occurred resulting in suspension or revocation of said license, and who had knowledge of or participated in the act or omisison which was the cause for such disciplinary action for violation of this chapter, the board shall require as a condition precedent to the issuance, reissuance or restoration of a license to such applicant, or removal of suspension, that such applicant file or have on file with the registrar a bond issued by an admitted surety in a sum to be fixed by the registrar based upon the seriousness of the violation but which sum shall not be less than three thousand dollars ($3,000) nor more than ten thousand dollars ($10,000) in favor of the

State of California, or in lieu thereof that such applicant or licensee post with the registrar a cash deposit in an amount based upon the seriousness of the violation but of a sum of not less than three thousand dollars ($3,000) nor more than ten thousand dollars ($10,000). *Such bond or cash deposit shall be for the benefit of (a) any person damaged as a result of a violation of this chapter by the licensee, (b) any person who, after entering into a construction contract with the licensee, is damaged by the failure of the licensee to perform the contract, (c) any person furnishing labor or materials used in the direct performance of a construction contract, and (d) any employee of the licensee damaged by the licensee's failure to pay wages or fringe benefits.*

*Such bond shall remain on file or in lieu thereof cash deposit be posted with the registrar for a period of at least two years and * * * for such additional time as * * * the registrar may determine.*

Each applicant or licensee shall be required to file only one bond of the type described in this section.

Nothing contained in this section shall apply to a person or firm whose license has been suspended or revoked pursuant to Section 7124.1 or for a failure to comply with Section 7083. (As amended Stats.1965, c. 1022, p. 2653, § 1; Stats.1965, c. 1025, p. 2659, § 1.)

APPENDIX F,

(Idaho Private Contractors' License Act)

54-2612. Bond for compliance.—No new license, as distinguished from renewal of an existing license, shall be issued by the board unless the applicant for such new license shall file, or have on file with the board, a bond issued by a surety company qualified to engage in business in Idaho in the principal amount of $1,000 running to the state of Idaho and conditioned upon applicant's compliance with all provisions of this act; or in lieu thereof applicant may deposit with the board cash in the amount of $1,000. Any person damaged because of a violation of this act by a contractor who has posted such bond or made such deposit, may bring an action in a court of competent jurisdiction within the state of Idaho on the bond of such contractor, or against the cash deposit if made, for the damages he has suffered because of such violation. All like claims which may be filed within thirty (30) days after the first such action is filed and thereafter diligently prosecuted to final judgment, shall share pro rata in the proceeds of such bond, or cash if deposited, if the bond, or cash deposit is not sufficient to pay all such such judgment in full. The total liability under such bond, or cash deposit, shall be $1,000.

The partial payment of any such claim shall not be considered as full payment and such claimant may bring a separate action against such contractor for any remaining unpaid balance thereof.

Failure of an applicant for license herein to file such required bond, or cash deposit, shall constitute ground for denying the application for license. The bond or cash deposit shall remain in full force and remain deposited with the board during the first year's operation of said licensee as a licensed contractor hereunder and shall be kept in effect thereafter unless released by order of the board. [1965, ch. 107, § 12, p. 201.]

APPENDIX G

(Idaho Public Contracts Bond Act)

54-1926. Performance and payment bonds required of contractors for public buildings and public works of the state, political subdivisions and other public instrumentalities—Requirements for bonds.—Before any contract for the construction, alteration, or repair of any public building or public work or improvement of the state of Idaho, or of any county, city, town, municipal corporation, township, school district, public educational institution, or other political subdivision, public authority, or public instrumentality, or of any officer, board, commission, institution, or agency of the foregoing, is awarded to any person, he shall furnish to the state of Idaho, or to such county, city, town, municipal corporation, township, school district, public educational institution, or other political subdivision, public authority, or public instrumentality, or to such officer, board, commission, institution, or agency thereof, bonds which shall became binding upon the award of the contract to such person, who is hereinafter designated as "contractor":

(1) A performance bond in any amount to be fixed by the contracting body, but in no event less than 50 per cent of the contract amount conditioned upon the faithful performance of the contract in accordance with the plans, specifications and conditions thereof. Said bond shall be solely for the protection of the public body awarding the contract.

(2) A payment bond in an amount to be fixed by the contracting body but in no event less than 50 per cent of the contract amount, solely for the protection of persons supplying labor or materials to the contractor or his subcontractors in the prosecution of the work provided for in such contract.

Each bond shall be executed by a surety company or companies duly authorized to do business in this state. In the case of contracts

of the state or a department, board, commission, institution, or agency thereof the aforesaid bonds shall be payable to the state, or particular state agency where authorized. In case of all other contracts subject to this act, the bonds shall be payable to the public body concerned.

Said bonds shall be filed in the office of the department, board, commission, institution, agency or other contracting body awarding the contract.

Nothing in this section shall be construed to limit the authority of the state of Idaho or other public body hereinabove mentioned to require a performance bond or other security in addition to these, or in cases other than the cases specified in this act.

It shall be illegal for the invitation for bids, or any person acting or purporting to act, on behalf of the contracting body to require that such bonds be furnished by a particular surety company, or through a particular agent or broker. [1965, ch. 28, § 2, p. 43.]

54-1927. Claims for labor or material furnished—Suit on contractor's payment bond—Procedure—Limitation.—Every claimant who has furnished labor or material in the prosecution of the work provided for in such contract in respect of which a payment bond is furnished under this act, and who has not been paid in full therefor before the expiration of a period of ninety (90) days after the day on which the last of the labor was done or performed by him or material was furnished or supplied by him for which such claim is made, shall have the right to sue on such payment bond for the amount, or the balance thereof, unpaid at the time of institution of such suit and to prosecute such action to final judgment for the sum or sums justly due him and have execution thereon; provided, however, that any such claimant having a direct contractual relationship with a subcontractor of the contractor furnishing such payment bond but no contractual relation-

ship expressed or implied with such contractor shall not have a right of action upon such payment bond unless he has given written notice to such contractor within ninety (90) days from the date on which such claimant performed the last of the labor or furnished or supplied the last of the material for which such claim is made, stating with substantial accuracy the amount claimed and the name of the person to whom the material was furnished or supplied or form whom the labor was done or performed. Each notice shall be served by mailing the same by registered or certified mail, postage prepaid, in an envelope addressed to the contractor at any place he maintains an office or conducts his business or at his residence.

The contracting body and the agent in charge of its office, is authorized and directed to furnish, to anyone making application therefor who submits an affidavit that he has supplied labor, or materials for such work and payment therefor has not been made or that he is being sued on any such bond, or that it is the surety thereon, a certified copy of such bond and the contract for which it was given, which copy shall be prima-facie evidence of the contents, execution, and delivery of the original. Applicants shall pay for such certified copies such reasonable fees as the contracting body or the agent in charge of its office fixes to cover the actual cost of the preparation thereof.

Every suit instituted on the aforesaid payment bond shall be brought in appropriate court in any county in which the contract was to be performed and not elsewhere; provided, however, that no such suit shall be commenced after the expiration of one (1) year from the date on which the claimant performed the last of the labor or furnished or supplied the last of the material for which such suit is brought, execpt, that if the claimant is a subcontractor of the contractor, no such suit shall be commenced after the expiration of one (1) year from the date on which final payment under the subcontract became due. [1965, ch. 28, § 3, p. 43.]

APPENDIX H

(North Carolina Bond re Handlers of Food Products)

§ 106-498. Establishment of financial responsibility before permit issued; bond.—No permit shall be issued to any handler who is not operating on a strictly cash basis and who is incurring or may incur financial liability to any grower, until such person, firm, or corporation shall furnish to the Commissioner of Agriculture sufficient and satisfactory evidence of their ability to carry out their contract or furnish a satisfactory bond in an amount not to exceed ten thousand ($10,000) dollars. The Commissioner of Agriculture may require a new bond or additional bonds up to the ten thousand dollar ($10,000.00) limit when he finds it necessary for the protection of the producer. Such bonds shall be payable to the State in favor of every contract producer or consignor of far mproducts, and shall be continued upon compliance with all the provisions of this article, and the faithful fulfilment of all contracts, and for the faithful accounting for and handling of produce by such handler, and for payment to the producer of the net proceeds of all consignments and sales. Any producer claiming to be injured by the fraud, deceit or willful negligence of any commission merchant or contractor, or by his failure to comply with this article or with the terms of a written contract between such parties, may bring action on the bond against both principal and surety in any court of competent jurisdiction and may recover the damages found by the court to be caused by such acts complained of. (1941, c. 359, s. 3.)

APPENDIX I

(Pennsylvania Bond re School District Contracts)

§ 7-756. Additional bond for payment of labor, materials, etc. It shall be the duty of every school district to require any person, co-partnership, association, or corporation, entering into a contract with such distirct for the construction, erection, installation, completion, alteration, repair of or addition to any public work or improvement of any kind whatsoever, where the amount of such contract is in excess of five hundred dollars ($500), before commencing work under such contract, to execute and deliver to such school district, in addition to any other bond which may now or hereafter be required by law to be given in connection with such contract, an additional bond for the use of any and every person, co-partnership, association, or corporation interested, in a sum not less than fifty per centtum (50%) and not more than one hundred per centtum (100%) of the contract price, as such school district may prescribe, having as surety thereon one or more surety companies legally authorized to do business in this Commonwealth, conditioned for the prompt payment of all material furnished and labor supplied or performed and all machinery used in the prosecution of the work whether or not the material or labor or use of machinery enter into and become component parts of the work or improvement contemplated. Such additional bond shall be deposited with and held by the school district for the use of any party interested therein. Every such additional bond shall provide that every person, co-partnership, association, or corporation, who, whether a sub-contractor or otherwise, has furnished material or supplied or performed labor in the prosecution of the work as above provided, and who has not been paid therefor may sue in assumpsit on said additional bond in the name of the school district for his, their, or its use, and prosecute the same to final judgment for such sum or sums as may be justly due him, them, or it, and have execution thereon. The school district shall not be liable for the payment of any costs or expenses of any suit. 1949, Marach 10, P.L. 30, art. VII, § 756.